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With the huge loans made to foreign governments and industries coupled with a decline in the holdings of foreigners in American securities and the increasing importance of our mercantile marine in the commerce of the world, our "invisible exports" will figure to a greater extent in our commercial relations with other nations than heretofore. Like the exports of merchandise and of gold, they make for the supply of foreign exchange and will tend to stimulate the importation of merchandise. As a creditor country, the debt due us and the interest on that debt will be paid by a relatively greater increase of imports than of exports. Our present highly "favorable balance" of trade will tend to be changed into an "unfavorable balance." Our "invisible exports" will probably exceed our "invisible imports," with the balance made up by a corresponding excess of "visible imports" over "visible exports."

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WASHINGTON NOTES

FREE USE OF COLLECTION SYSTEM

Important changes in the Federal Reserve transit and collection system have been determined upon and went into effect June 15. The result of the changes is expected to be that of popularizing to a very considerable extent the use of the exchange and collection facilities of the system. In substance the changes result in cutting off a number of charges that have been made for the use of the collection system, such elimination being rendered possible by the very considerable earnings that are now being realized by practically all Federal Reserve banks. These changes come as the logical next step in the development of the plan first made effective practically two years ago. In summary the alterations now provided for are as follows:

1. The Board approves the recommendation to suspend, or eliminate for the time being, service charges for the collection of cash items; this elimination of charges to apply to checks received from member banks and from other Federal Reserve banks and to become effective on and after June 15, 1918.
2. The Board approves the recommendation that the 10 cent charge on collection items between Federal Reserve banks be eliminated for the present

and until further notice, but that a charge of 15 cents per item be made on all such items returned unpaid, this rule to become effective June 15, 1918.

3. The Board approves the recommendation that telegraphic transfers be bought and sold at par, each Federal Reserve bank absorbing the telegraphic expense, but with the proviso that checks on other Federal Reserve cities or Federal Reserve branch cities be taken at par, subject only to deferred availability in accordance with regular time schedules.

4. The Board approves in principle the recommendation that the discount rate on mail transfers be based upon the fifteen-day rate, but, because it is desirable that the rate for such transfers shall remain as nearly uniform as possible and not vary too frequently, suggests that for the time being and until further notice a charge of 10 cents per day per thousand, or at the rate of 3.65 per cent be fixed as the rate for all mail transfers.

5. The Board approves the recommendation of the Transit Managers, indorsed by the governors, "that all mail transfers to banks in other Federal Reserve cities be made by draft on the Federal Reserve Bank and sent direct to the bank to which the transfer is ordered, rather than to the Federal Reserve Bank."

6. The Board approves the suggestion that there shall be a general revision of all time schedules, effective June 15, 1918, which shall take into consideration recent changes in mail train schedules, and the creation of new collection centers at branch bank cities.

7. The Board approves the recommendation that "trade acceptances," wherever payable, be handled as collection items, not as checks or cash items, but suggests that "bankers' acceptances" be treated as cash items.

The Board has under consideration and expects to approve a plan for linking together by private telegraph system the twelve Federal Reserve banks with its office at Washington, and expects to have these additional facilities available within a short time.

TREASURY FINANCING FOR 1918

In an announcement dated June 12 the Secretary of the Treasury has made public what is practically the program of the Treasury financing for the coming year. The new plan is practically an extension of the system adopted in February last whereby large quantities of Treasury certificates are offered to the banks at short intervals in amounts roughly proportionate to their resources. The banks are expected to purchase and hold these certificates pending the floating of an issue of long-term bonds whose proceeds are then used to fund the maturing certificates. The expenditures of the government, as nearly as can be estimated, will require the sale of certificates of indebtedness up to the first of November, 1918, aggregating approximately \$6,000,000,000. This would involve

the issue every two weeks of about \$750,000,000 of certificates substantially similar in character to those issued prior to the Third Liberty Loan, except that they will have various maturities not exceeding four months. For the months of July and August that program will be followed as nearly as possible. The first issue of the certificates will be dated June 25, will mature October 25 with interest at $4\frac{1}{2}$ per cent, and similar issues, it is expected, will be made on Tuesday of every other week following June 25.

It is contemplated, however, that at a convenient and favorable period during the summer an offering will be made to the general public directly, and through the banks, of an amount yet to be determined, perhaps \$2,000,000,000 of certificates of suitable maturities for use by taxpayers in paying next year's taxes, viz., taxes payable June, 1919, levied under existing and pending legislation. To the extent that certificates of that character are sold, substantially an equivalent reduction in the amount of the regular fortnightly sale of certificates issued in anticipation of the next Liberty Loan will be effected. Early information of the estimated requirements of the Treasury is being conveyed to all the banks of the country, and, through them, to those who expect to make payment of taxes in 1919. They will be asked to make arrangements promptly and of such a character that no delay will be experienced in the sale and distribution of Treasury certificates of both issues. The Federal Reserve banks will advise all national and state banks in their respective districts of the amount of certificates which they are expected to take from time to time in pursuance of this program—a sum which can be figured roughly to equal $2\frac{1}{2}$ per cent of gross resources of each bank and trust company for every period of two weeks, or a total of 5 per cent monthly. It will be remembered that in the February program the amount which the banks were asked to take was substantially equal to 2 per cent of the gross resources for each period of two weeks, or a total of 4 per cent monthly.

The total number of bi-weekly offerings of certificates to be made to the banks will depend somewhat upon the amount to be raised from the public through the sale of tax certificates as described above. The proposal thus placed before the banks is practically equivalent to a doubling of the financing of the past spring and winter, and its eventual success will clearly depend upon the ability to float a proportionately enlarged Liberty Loan which will be the fourth of the series. Assuming that this next Liberty Loan is placed at about the time the first issue of the certificates matures, the loan would evidently be offered toward the end of

September. Could the country at that time successfully purchase and absorb, say, six billions of Liberty bonds? The placing of the new financing upon practically this scale is clearly necessary if the present financial and military program is to be carried out. Possibly the most serious doubt in this connection is furnished by the question whether it is in fact feasible and practicable to spend the amount of money which is to be raised without merely increasing prices of commodities to a corresponding degree and thus really defeating or at least not advancing the essential object of the plan.

NEW TAXATION

It is of course recognized that the whole success of a financial program upon so great a scale must depend upon the laying of a satisfactory foundation for it by means of new taxation. Up to a very recent date it had been assumed that no such new taxes would be levied during the current year, and the Secretary of the Treasury had expressed this belief in his *Annual Report*. The increasing necessities of the government and the growing demands of the allied countries established a basis for suggesting the alteration of this tentative understanding, and such suggestions have been confirmed by the growing conviction that the present income and excess profits law is unsatisfactory and would be unworkable were it not for the unusual co-operation of the community under the stress of war conditions. This situation led to the outspoken declaration of the President in his address to Congress on May 27 when he took definite action in favor of a new measure of taxation, whose necessity has now been reluctantly accepted by Congress.

In a letter to the Chairman of the Ways and Means Committee dated June 5, the Secretary of the Treasury furnishes some detailed data designed to substantiate the belief that immediate action is requisite. The statistical tabulations submitted show that in March, 1917, the expenditures were in round figures \$100,000,000. In May, 1918, they were \$1,508,195,000. If there should be no further increase during the coming fiscal year, the cash expenditures upon the May basis would be more than \$18,000,000,000. If, as seems inevitable, the increase in expenditures should continue at the rate of \$100,000,000 per month for the next six months, or until December, 1918, and if thereafter the monthly expenditures should remain stationary until June 30, 1919, the Treasury would have to finance expenditures aggregating \$24,000,000,000 during the fiscal year ending June 30, 1919; or, to put it in another way, if the average monthly expenditure should exceed that for the month of May,

1918, by $33\frac{1}{3}$ per cent, it will be necessary to provide \$24,000,000,000 in the fiscal year 1919.

In the fiscal year ending June 30, 1918, cash disbursements will amount to between \$12,500,000,000 and \$13,000,000,000. Of this amount about one-third will have been raised by taxes and two-thirds by loans, all of which will be represented by long-time obligations, that is, bonds of the First, Second, and Third Liberty Loans and War Savings Certificates. On the strength of this showing it would thus appear that with taxes producing their present yield it would be necessary to raise, by borrowing, during the fiscal year 1919 about \$20,000,000,000. The danger or impossibility of such an attempt is obvious and hence the development of a plan to raise at least \$8,000,000,000 from taxation. In order to get the amount required the Secretary of the Treasury makes the following suggestions:

1. That one-third of the cash expenditures to be made during the fiscal year ending June 30, 1919, be provided by taxation. According to estimates this would involve raising \$8,000,000,000 through taxation.

2. That a real war profits tax at a high rate be levied upon all war profits. This tax should be superimposed upon the existing excess profits tax in such a way that the taxpayer should be required to pay whichever tax is the greater. The existing excess profits tax should be amended in certain important particulars so as to remove inequalities.

3. That there should be a substantial increase in the amount of normal income tax upon so-called *unearned* incomes. Under existing law *earned* incomes above certain exemptions are taxed 4 per cent as an income tax and 8 per cent as an excess profits tax, making a total of 12 per cent, while *unearned* incomes, derived from securities, etc., are taxed only 4 per cent. The 8 per cent tax should be recognized as an income tax and the rate of 12 per cent (4 per cent normal and 8 per cent excess profits) should be retained in respect to *earned* incomes, while a higher rate than 12 per cent should be imposed on *unearned* incomes.

4. That heavy taxation be imposed upon all luxuries.

The program thus outlined, taken in conjunction with the immense borrowing plan, will come close to doubling the burdens imposed upon the community during the past year and again raises the question whether there is a savings margin in the country large enough to provide means for carrying any such load. Up to date the highest estimate of produced wealth over consumption, i.e., savings, has been \$18,000,000,000. If \$24,000,000,000 is to be obtained, there must, therefore, be either an increased production or a decreased consumption amounting

to \$6,000,000,000. That the amount required can be obtained by either method is naturally gravely to be doubted, and the alternative—that of merely bidding up prices through urgent demand for goods—presents itself as a danger.

RAILROAD RATES AND WAGES

Probably the most important action yet taken by the Director General of the Railroads is Order No. 28, issued on May 25, and relating to rates and fares on the railroads of the country. As has been widely announced, the effect of this order is to bring about an increase of about 25 per cent in nearly all freight rates, while, at the same time, passenger fares are increased to three cents a mile. What is practically a distinction between first- and second-class fares is introduced by the addition of an extra charge of $16\frac{2}{3}$ per cent of the regular fare for the validation of ordinary tickets in sleeping and parlor cars. The advance in rates thus affected is notable, coming as it does practically contemporaneously with Order No. 27, which accords to railway employees increases of salary and back pay variously estimated at upwards of \$300,000,000. The effect of the two orders taken together is thus to produce a very material increase in the pay of railway employees while placing the cost of it upon the public. Even more significant, however, is the fact that the order providing for freight-rate increases does not stop with the 25 per cent advance that has been ordered, but goes on to direct other advances and reclassifications which, when placed in conjunction with the flat increase of 25 per cent already described, will necessarily bring about an alteration in the whole freight-rate structure.

The act of March 21 authorized the President, whenever in his opinion public interest requires, to initiate rates, fares, changes in classifications, regulations, and practices. This gave to the administration absolute authority over practically every phase of railroad operation. The President (which in practice means the railroad administrator appointed by him) has to file his changes with the Interstate Commerce Commission, and it was provided that such changes should not be suspended by the Commission pending final determination. The Commission retains, under the law, power to enter upon a hearing concerning the reasonableness of any of these orders of the President, and to make such findings and orders as they are authorized to make under the act to regulate commerce, except that if the President should find and certify to the Interstate Commerce Commission that any given change was necessary in order to increase revenues the Commission shall take into

consideration this finding by the President. This latter provision probably means in practice that the Commission would seldom, if ever, alter an order made by the Federal Railroad Administration except as to some matter of detail or practice, inasmuch as the main reason for making the change would be likely to be that of increasing the income of the roads. It is substantially true, therefore, that the status of the Interstate Commerce Commission was quite materially altered inasmuch as the changes of rates and practice determined on by the government now go into effect without delay and must remain in effect subject only to what is likely to be a rather limited power of modification by the Commission. The power of the Federal Railroad Administration will be further greatly increased by the authority carried in the act to order the making of additions, betterments, or extensions, and if necessary to advance the funds for that; but the power to raise rates has naturally been the first to be employed.

The action taken in advancing rates at this time is regarded by many persons as a substantial vindication of the position of the roads in recent years. They have for a long time urged an increase of rates, but their applications have been almost unanimously rejected by the Interstate Commerce Commission. Whether the roads are restored to private management on the old basis or not at the end of the war, the effect of the action now taken is undoubtedly that of materially strengthening the claim of the roads to what they call a "living wage"—that is to say, to rates that will enable them to pay their expenses and fixed charges, and which, therefore, increase as the latter increase. On the other hand, the action taken is likely to make it harder to restore the roads to private ownership, partly because the stockholders may prefer a situation in which they are protected against loss, if that situation can be maintained, and partly because, under the new arrangement of freight rates and other changes of like kind, which will doubtless follow, there is likely to be a material redistribution of traffic. Altogether Order No. 28 opens an entirely new period in the history of railroad management under federal control.

CONTROL OF FOREIGN EXCHANGE

The development of the gold-embargo policy and the strengthening of public control of foreign exchange is bringing about in the trade of the United States the development of new conditions which are necessarily leading to the application of further methods of commercial regulation. Up to date under the gold embargo there have been granted licenses for the importation of about \$60,000,000 gold, \$160,000,000

silver, and \$30,000,000 currency in round numbers, or a total of approximately \$250,000,000. The value of the dollar in foreign markets has continued to decline because of the difficulty of obtaining means of remittance for the purpose of settling balances.

Peculiar conditions are recognized as surrounding the gold situation, due to the fact that as a result of the war and limitations upon trade it is not possible, as in times of peace, to offset foreign balances against one another. The situation is leading to the negotiation of special agreements with various foreign countries for the regulation of exchange relationships, many of these being based upon undertakings to export net balances of gold within a specified period after the close of the war. Congress has made provision by law for the sale of bonds abroad, payable in terms of foreign currency, and this may render it possible in some instances to provide a means of liquidating balances due to those countries.

In some cases conditions have become so acute as apparently to require direct regulation of payments. In the case of Italy, for example, it has been deemed best to effect an adjustment whereby the practical supervision of each transaction is placed in the hands of a committee representing the Italian and American governments. Experience in connection with our foreign exchange relations is very similar to that already had by foreign countries which have attempted the same method of restricting payment. The interesting question in the whole matter is whether it will be possible to bring about a general control of financial relations with foreign countries unless trade relations with them are first subjected to such control. Thus far the regulation of trade relationships has been in the hands of the War Trade Board, but that Board has been governed very largely by military considerations and has given comparatively little attention to the commercial side of our foreign business.

Within the past sixty days the United States Shipping Board has come forward as a part of the system of regulation by applying methods for the control of tonnage. Under this plan those who wish to import commodities into the United States must obtain tonnage through assignment by the government. They are thus obliged to secure not only importation licenses but must also secure in practice action which will furnish them with the means of moving their goods. As yet it is uncertain how far this system will be worked out upon a strictly economic basis, that is, with a view to adjusting trade balances and thus relieving the disturbances to exchange and other financial relationships with for-

eign countries. As the war continues for a longer and longer period the necessity of a general limitation upon foreign business will grow more and more pressing, and the adoption of temporary measures designed to relieve difficulties in the exchange situation will become necessarily less and less effective. This is even now being made evident by the difficulties already referred to in connection with the tendency of the dollar to depreciate in buying power abroad as compared with currency units of the countries with which we are doing business.